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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, DECEMBER 2, 1985 VOLUME XXII, NUMBER 43

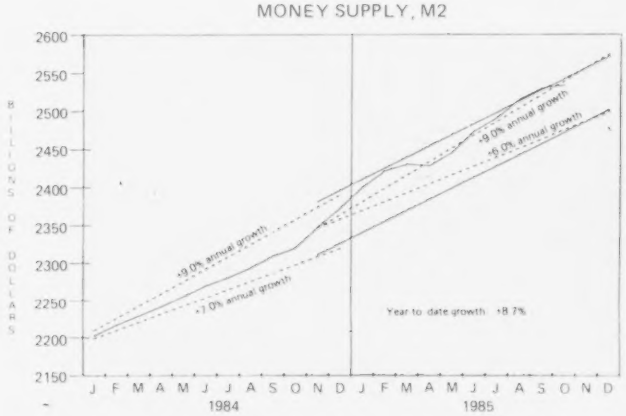
Monetary Policy May Remain On Hold . . .

Amid a continuing barrage of mixed economic signals, still modest rates of inflation, within-target M2 and M3 money supply growth and, perhaps most important, widespread expectations that an easing of monetary policy is just around the corner, powerful bond and stock market rallies erupted in recent weeks—sending bond yields tumbling and share prices soaring. However, despite the current bullish sentiment, the financial markets may have gotten ahead of themselves. The combination of an upward revision of third-quarter GNP and rapid M1 money supply growth could cause the Federal Reserve to hesitate before easing monetary policy further. Add to this the need to guide the dollar lower gradually, rather than all at once, and the likelihood of a steady, yet quite accommodative monetary policy posture in the weeks ahead becomes an even better bet. While this could change quickly if the pace of business softens, it may be early January before such evidence would become available.

In the economy itself, the appearance of economic sluggishness has been viewed as good news by the debt markets. It raises the possibility of greater monetary policy ease in order to stimulate the economy—and, as a result, lower interest rates and higher bond prices. Nor does one have to look far to find signs of economic malaise, especially in the manufacturing sector. Factory orders remain weak, industrial production is only slightly higher than a year ago and capacity utilization rates nationwide are actually lower. What is more, auto sales have tumbled since the elimination of dealer financing incentives, and building permits have headed south as well. So far, so good—at least for the debt markets. However, despite all this, third quarter real gross national product growth was revised upward from a 3.3 percent to a 4.3 percent annual clip, while the rise in inflation-adjusted domestic demand—which nets out of GNP the growth retarding effects of the trade deficit—was even more brisk, advancing at a nearly 5½ percent seasonally adjusted annual rate. Not bad, for an economy supposedly moving sideways at best.

But that's yesterday's news. Perhaps more important is the fact that GNP growth in the current quarter could be relatively brisk as well—despite the easing of auto sales and signs of a slowing in consumer spending in general. For one thing, although auto sales are now running some 33 percent below the torrid, third quarter pace, automakers continue to schedule, and stick to, hefty production schedules. While this cannot continue forever, that's not what counts for now. For rather than subtracting from GNP growth, the growing divergence between sales and production could actually increase it, with today's involuntary buildup in auto stocks showing up in the fourth quarter gross national product as a sizable increase in inventory accumulation. For another, any improvement in the trade balance deficit in the current quarter will also be a plus, further boosting GNP growth. On balance, while recent business trends do not preclude another round of Fed easing, they may not hasten it either.

MONEY SUPPLY, M2



. . . Despite Widespread Expectations . . .

Much the same can be said of recent money supply developments. Take, for example, the M1 money numbers. Despite repeated disclaimers, there is still a lingering suspicion that M1 matters—at least to some extent. If it does, the news is not good. After slowing in October, the growth of this measure has actually perked up again, advancing at a nearly five percent annual rate over the last four weeks, compared with almost no growth during the immediately preceding four weeks. What is more, this money supply measure now stands some $8 billion

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above its rebased 1985 upper target boundary. However, on the other hand, the year-to-date growth of the closely watched M2 money number is now within its narrow target boundaries for the first time since last spring (see chart), while M3 remains squarely within its target ranges. The Fed thus finds itself with two of its three money supply numbers under control—a further justification for ignoring M1, if desired. But, as with recent business trends, money supply developments, too, can be used as a rationale for whatever the Fed wants to do, whether maintaining policy on hold, or switching toward greater ease.

So, too, the dollar's influence on Fed policy cannot be minimized. Despite all the talk of a weak dollar, it remains some 50 percent higher on a trade-weighted basis than where it stood in mid-1980 (Financial Digest—November 25, 1985). What is more, the dollar's persistent strength is again affecting adversely the outlook for global economic activity. One example is the recent rise in Japanese interest rates in order to strengthen the yen—a move clearly at cross-purposes with official efforts to stimulate Japanese economic growth. While it has resulted in a further appreciation of the yen against the dollar, a longer-lasting solution to the problem of U.S. manufacturers in general, and exporters in particular, remains faster, not slower economic growth in the other industrial countries.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 11/20/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov't s and Agencies			
Owned Outright & RPs	179.798	– 1.085	+15.665
Loans to Depository Inst.	1.565	+ .774	– 2.703
Float	1.556	+ .059	+ .664
Total Reserve Bank Credit	196.580	– 1.678	+16.334
Treasury Deposits with			
Federal Reserve Banks	3.008	– .056	– .501
Currency in Circulation	191.568	+ .177	+12.467
Gov't s held for Foreign Acct.			
by F.R. Banks (End-of-Week)	124.617	+ .635	+ 6.940
	11/20/85		
Member Bank Reserves:			
Total Reserves Held	44.717	+ 1.115	+ 5.862
Excess (Deficiency)	.980	+ .157	+ .385
Net Free Reserves	.324	– .022	+ .316
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (11/18/85)	616.6	+ 8.0‡	+ 11.7‡
M2 (October '85)	2,533.4	+ 6.9	+ 9.2
M3 (October '85)	3,174.5	+ 7.7	+ 8.5
Domestic Nonfinancial Debt (2nd Q'85)	6,317.3	+ 12.2	+ 13.6

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 11/29/85	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.15%	7.25%	7.30%
* Federal Agencies	7.40	7.45	7.50
* Municipal Notes—High Grade (46% Taxable Equivalent)	9.26	10.19	10.65
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.85	7.85	7.90

‡ Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.70%	Dec.	7.80%
15- 29 days	7.80	Jan.	7.75
30- 59 days	7.80	Feb.	7.70
60- 89 days	7.80	Mar.	7.65
90-179 days	7.77	Apr.	7.65
180-239 days	7.75	May	7.60
240-270 days	7.75		

‡ Industrial Paper—Prime			
30- 89 days	7.80%	†Federal Funds Effective Rate	9.00%
90-120 days	7.80		

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'85	$ 3,916	$ 3,853	$ 3,695
Gross National Product (1972 Dollars)*	3rd Q'85	$ 1,689	$ 1,671	$ 1,645
Percent Change, Annual Rate	3rd Q'85	4.3	1.9	1.6
Change in Consumer Prices*	Oct '85	3.6%	2.4%	3.6%
Change in Producer Prices*	Oct '85	10.8%	– 7.2%	– 1.2%
Civilian Employment (Thousands of Persons) †	Oct '85	107,867	107,544	105,649
Unemployment as % of Civilian Labor Force †	Oct '85	7.1%	7.1%	7.3%
Personal Income*	Oct '85	$ 3,221	$ 3,207	$ 3,079
Leading Indicators Composite Index (1967=100)†	Sep '85	170.3	170.2	165.7
Industrial Production Index (1977=100) †	Oct '85	124.9	124.9	122.7
Net Change in Consumer Installment Credit †	Sep '85	$ 10.63	$ 6.31	$ 4.98
U.S. Merchandise Trade Balance †	Oct '85n	–$ 11.45	–$ 15.55	–$ 9.65
Plant and Equipment Expenditures*	4th Q'85	$387.40(a)	$389.54(a)	$368.29
Private Housing Starts (Thousands of Units)*	Oct '85	1,760	1,589	1,564
New Construction Expenditures*	Sep '85	$ 350.4	$ 343.9	$ 321.0
Total Business Inventories †	Sep '85	$ 579.5	$ 578.2	$ 565.5
Total Business Sales †	Sep '85	$ 428.5	$ 430.4	$ 412.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

. . . Of An Imminent Turn Toward Ease

Although the desire to lower the dollar's external value tends to suggest the need for more accommodation and lower interest rates here, the most obvious course of action may not be the most appropriate. Getting the dollar lower in the foreign exchange markets is one thing; a rapidly depreciating currency and a revival of inflation expectations is another. As with recent business trends and money supply developments, the Fed has to walk a fine, and sometimes conflicting line—balancing the obvious benefits of more ease, against some less apparent problems which could arise from such a move.

What's the bottom line? For one thing, in light of the ongoing liquidity problems of some advanced developing countries as well as the virtual absence of any significant inflation rate pressures, it is unlikely that the Federal Reserve would tighten the money and credit reins. On the other hand, it may hesitate before easing further, given the better GNP numbers, rapid M1 growth, and a desire not to touch off too quick a depreciation of the dollar in the foreign exchange markets. Only if the pace of business clearly softens, and the Christmas selling season falters would the stage be set for another round of ease. This may, however, have to await the turn of the year, when December's business numbers begin to filter in.

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Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (11/13/85)	157,069	– 238	– 1,738
New York City (11/13/85)	33,114	– 365	– 743
Commercial Paper (11/13/85)	288,343	+ 1,966	+54,248

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/13/85)	253,526	– 1,488	+ 3,268
New York City (11/13/85)	59,700	– 684	– 4,590

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/13/85)	697,939	– 949	+ 51,801
New York City (11/13/85)	152,752	– 570	+ 8,704

Financial Markets

	Friday 11/29/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.39%	– .07	– 1.36
180-Day Bills†	7.64	– .04	– 1.51
Longest Bills†	7.84	+ .03	– 1.86
Recent Issues:			
8 1/2s 11/30/87	8.49	– .04	
9 3/8s 9/30/89	8.95	– .06	
9 1/2s 11/15/95	9.59	– .03	
9 7/8s 11/15/15 (When Issued)	9.86	NA	
Municipals:			
Bond Buyer–20 Bond Index* (11/27/85)	8.51%	+ .14	– 1.53
Blue List Total ($ Million)	$2,033	+$ 405	+ $ 383
30-Day Visible Supply ($ Million)	$7,712	+$2,826	+ $4,709
Total	$9,745	+$3,231	+ $5,092
Corporates:			
Moody's Aa Composite (11/26/85)	10.97%	– .01	– 1.53
30-Day Visible Supply ($ Million)	$2,158	+$ 360	+ $ 658
Stocks:			
Dow-Jones Averages:			
Industrials	1,472.13	+ 11.35	+ 283.19
Transportation	690.31	+ 2.81	+ 168.06
Utilities	164.03	– 1.85	+ 18.41
65 Stocks	589.22	+ 2.34	+ 115.02
Standard and Poor's 500 Stocks	202.17	+ .65	+ 38.59
N.Y.S.E. Composite Index	116.55	+ .31	+ 22.25
N.Y.S.E. Avg. Daily Vol. for Week (000's)	110,848	–14,148	+ 28,334

* 46% Taxable equivalent 15.76%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/29/85	Week Ago
Overnight	7.88%	7.56%
1 month	8.06	8.00
3 month	8.06	8.00
6 month	8.06	8.00
1 year	8.19	8.19
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	9.46%	9.50%
Long Term (7 to 15 yrs.)	10.03	10.05

FOREIGN EXCHANGE SPOT RATES

New York Opening (11/29/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01963	50.9500
Canada	.7253	1.3788
Denmark	.1090	9.1725
France	.1305	7.6650
Germany	.3979	2.5130
Italy	.0005867	1704.50
Japan	.004949	202.08
Mexico	.002051	487.50
Netherlands	.3539	2.8258
Switzerland	.4805	2.0810
U.K.	1.4830	.6743

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